Appendix 2

Before the Enforcement Division of the Securities and Exchange Commission

In the Matter of CapWealth Advisors, LLC	SEC File No. A-03907-A

EXPERT REPORT OF JONATHAN R. MACEY

June 13, 2020

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I. Introduction

A. Qualifications

1. I am the Sam Harris Professor of Corporate Law, Corporate Finance, and Securities Law at Yale Law School, and a Professor at the Yale School of Management. I am also a member of the Provost's Standing Advisory & Appointments Committee for the Yale School of Management, and Chair of the Yale University Advisory Committee on Investor Responsibility. I serve on the Executive Committee of the Yale Law School Center for the Study of Corporate Law. I am also a member of the European Corporate Governance Institute. I serve on the Members Consultative Group for the American Law Institute's Restatement of the Law/Corporate Governance Project. I teach courses on Business Organizations, Corporate Governance, Corporate Finance, and Banking and Financial Institutions Regulations. Additionally, I have authored more than 100 articles and more than half a dozen books on topics including corporate governance, the regulation of the financial services industry, and the economic role of reputation in corporate finance and investment banking.[1]

2. Prior to joining the Yale faculty in 2004, I taught at Cornell University as the J. DuPratt White Professor of Law from 1991 to 2004. I was also a tenured law professor at the University of Chicago from 1990 to 1991 and Cornell University from 1987 to 1990. I have been a visiting professor at several universities including Harvard, the Stockholm School of

[1] These publications include, in addition to articles focused on the law and economics of best execution and on conflicts of interest cited herein, "Macey on Corporation Laws" (two volume treatise) (originally published in 1998, updated annually, Wolters Kluwer Law & Business, 2019); "Cases and Materials on Corporations Including Partnerships and Limited Liability Companies" (Thomson*West, thirteenth edition, 2017) (with Robert Hamilton and Douglas Moll); "The Law of Banking and Financial Institutions" (Aspen Law & Business, sixth edition, 2017) (with Richard Cornell and Geoffrey P. Miller); "The Death of Corporate Reputation: How Integrity Has Been Destroyed on Wall Street," (The Financial Times Press, 2013); "Corporate Governance: Promises Kept, Promises Broken" (Princeton University Press, 2008); "Classics in Corporate Law and Economics," Jonathan Macey, editor (Edward Elgar Publishing, 2008); "Iconic Cases in Corporate Law," Jonathan Macey, editor (Thomson*West, 2008); and "The Value of Reputation in Corporate Finance and Investment Banking (and the Related Roles of Regulation and Market Efficiency)," 22 Journal of Applied Corporate Finance, 18-29 (2010).

Economics, the University of Tokyo, and the University of Virginia. Outside of academics, I serve as a member of the Economic Advisory Board of the Financial Industry Regulatory Authority (FINRA).

3. I have more than 30 years of experience in the research and study of corporate governance, financial institutions, and securities regulation, including disclosure policy, conflicts of interest and the duty of best execution from the perspective of economic and public policy. My expertise also includes knowledge of the policies underlying the regulation of mutual funds. In the course of my research, I have also extensively reviewed corporate filings, including SEC filings by mutual funds and public companies, and corporate governance documents. My complete curriculum vitae, which includes a list of my publications, is attached as **Appendix A** to this Report.

4. I am being compensated at my current standard rate of $1,250 per hour for my time and reimbursed for my out-of-pocket expenses in connection with my review of the record, preparation of this Report, and provision of testimony. My compensation is not dependent on the content of my Report or testimony or the outcome of this investigation or any subsequent litigation. My prior testimony over the past four years is provided in **Appendix B**.

B. Scope of Engagement

5. I have been retained by Leader, Bulso & Nolan, PLC, and Cahill, Gordon Reindel LLP counsel for the CapWealth Advisors LLC parties,[2] ("CapWealth Advisors") to analyze the imposition and disclosure of certain 12b-1 fees paid by CapWealth clients from a public policy and economic perspective. Specifically, I analyze the materiality of any alleged non-disclosure

[2] The CapWealth Advisors LLC parties include CapWealth Advisors, LLC, Timothy J. Pagliara, and Timothy R. Murphy.

of such fees from the perspective of ordinary and customary investment advisor behavior. I also analyze the appropriateness and quality of the disclosures that were made. Finally, I analyze the trades involving 12b-1 fees from the point of view of investment advisers' duty of best execution of customers' orders, to the extent that such a duty applies in this context.[3]

C. Information Considered

6. In forming my opinions, I have drawn upon my education, experience, and knowledge acquired through decades of teaching, research and writing in the economics and public policy of disclosure, best execution of trading orders, corporate governance, economics, law and economics, finance, and other areas of expertise.

7. I reserve the right to modify or supplement the opinions expressed in this Report, including in response to the review of new evidence, in response to opinions or arguments by any expert that the Commission may retain, and in response to any ruling by a Court or administrative judge.

II. Summary of Opinions

8. Below are summaries of the four (4) opinions that I have formulated in this matter. I hold these opinions to a high degree of certainty. I discuss and provide support for these opinions in the sections that follow.

- Any alleged failure to disclose was not material. The record indicates, and for purposes of this Report I have assumed, that CapWealth's investment advisors generally selected the mutual fund share class for its clients that offered the best overall terms of execution available. CapWealth's management and governance practices as they related to fees deprived investment advisors of any incentive to guide clients towards higher fee share classes because CapWealth discounted its standard advisory fee (or provided other

[3] See Part IV. C., *infra* for a discussion of the interaction of Rule 22c-1's forward pricing obligation with the duty of best execution.

discounts) to off-set any 12b-1 fee imposed by a fund, such as in cases where only a share class that paid a 12b-1 fee was available to a particular investor, or when paying a 12b-1 fees and deducting the fee from the standard advisory fee was best for the client for the tax reasons discussed below.[4] This fact differentiates CapWealth from other advisors who may have faced conflicts because they had a financial incentive to select a higher cost share class that paid a 12b-1 fee. This substantive difference makes disclosure immaterial.

- The SEC has long taken a practical, sensible, holistic approach to disclosure. Here appropriate disclosures of 12b-1 fees were made in a variety of ways, including by prospectus, confirmation and actual in-person conversations with clients. Any decision to insist that disclosure is only proper and appropriate if it is contained in Form ADV Part 2A is inconsistent with long-standing SEC disclosure policies that provide significant benefits to investors.

- To the extent that the duty of best execution applies in this context, it requires brokers and investment advisers to provide their customers the most favorable terms commercially available for their trades. Here the record indicates that CapWealth customers who paid 12b-1 fees received best execution of their trades, even if the definition of best execution is expanded to include the post-execution fees for expenses imposed by a mutual fund.

- The Record shows that CapWealth's corporate governance was directed at instilling a culture of compliance in the firm. This culture of compliance, which included hiring expert advisors to guide the 12b-1 disclosure process, indicates that a lack of scienter or intention to engage in wrongdoing

III. Background Facts and Context

9. Recently, the Securities and Exchange Commission ("Commission") has filed numerous actions in cases in which an investment adviser failed to make certain disclosures relating to its selection of mutual fund share classes that paid the adviser (as a dually registered broker-dealer) or its related entities or individuals a fee pursuant to Rule 12b-1 of the Investment

[4] See *infra* footnote 42. The term "12b-1 fee" is used to describe the fees charged to customers for the costs of marketing, distributing and account servicing. This fee includes the fees paid to compensate brokers who sell fund shares. FINRA rules dictate that 12b-1 fees cannot exceed 1.00%. 12b-1 payments are mainly used "to compensate sales professionals for advice and assistance given to buyers of fund shares." John D. Rea & Brian K. Reid, *Trends in the Ownership Cost of Equity Mutual Funds,* INV. CO. INST. PERSPECTIVE, Nov. 1998, at 1. Such payments have been justified on the ground that they are assessed "not only to encourage growth, but also to stimulate improved shareholder service." Krinsk v. Fund Asset Mgmt., Inc., 715 F. Supp. 472, 490 n.37 (S.D.N.Y. 1988).

Company Act of 1940 ("12b-1" fee) when a lower-cost share class for the same fund was available to clients.[5]

10. The levying of 12b-1 fees began in the 1980s when the SEC formally recognized that mutual funds could pass distribution costs directly to shareholders.[6] While such fees are controversial in some circles,[7] properly used, they provide a valuable mechanism for incentivizing brokers and investment advisers to educate unsophisticated clients about the benefits of mutual funds and diversified equity investing. Such fees provide an avenue by which certain clients appropriately can add equity investments to asset portfolios that might otherwise consist entirely of bank accounts of various kinds. Put simply, the fees associated with mutual funds are socially desirable and efficient when properly used because they allow the financial system to achieve the ultimate goal of mutual funds, which is to "allow those with relatively little wealth, education or information to invest in securities."[8]

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[5] February 12, 2018, United States Securities and Exchange Commission, Announcement, "Share Class Selective Disclosure Initiative," https://www.sec.gov/enforce/announcement/scsd-initiative (hereinafter SCSDI); See also, SEC Press Release, 2018-15, "SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors," https://www.sec.gov/news/press-release/2018-15

[6] 17 C.F.R. § 270.12b-1 (1999). Shortly after the adoption of Rule 12b-1 thousands of mutual funds adopted rule 12b-l plans. Joel H. Goldberg & Gregory N. Bressler, Revisiting Rule 12b-1 Under the Investment Company Act, 31 SEC. & COMMODITIES REG. REV. 147 (1998). Rule 12b-1 fees provide a means by which pricing and distribution could be reordered through the imposition of conditional deferred sales loads. Terry R. Glenn et al., *Distribution in Mid-Decade: Coping with Success and Other Problems, in* INVESTMENT COMPANIES 1986, at 84 (PLI Corp. Law Practice Course, Handbook Series No. B4-6746m 1986).

[7] John C. Bogle, Mutual Fund Industry Practices and their Effect on Individual Investors, Statement before the U.S. House of Representatives, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Committee on Financial Services (Mar. 12, 2003).

[8] John Coates and Glenn Hubbard, Competition in the Mutual Fund Industry: Evidence and Implications for Policy, at 46 http://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_592.pdf . In addition to competing on price, mutual funds also compete on the basis of equity mutual funds compete on non-price factors such as service quality and scope, reputation of fund managers, breadth of fund complex, and, most importantly, performance returns to shareholders. U.S. General Accounting Office, Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition, GAO/GGD-00-126 (Washington, D.C.: June 7, 2000).

11. On February 12, 2018, the Commission announced its Share Class Selective Disclosure Initiative (SCSD Initiative).[9] In the SCSD Initiative, the Division of Enforcement announced that it would recommend that the Commission accept favorable settlement terms for investment advisers that self-report to the Division possible securities law violations relating to their failure to make necessary disclosures concerning mutual fund share class selection.[10]

12. The SCSD Initiative targets Investment advisers "that did not explicitly disclose in applicable Forms ADV (i.e., brochure(s) and brochure supplements) the conflict of interest associated with the 12b-1 fees the firm, its affiliates, or its supervised persons received for investing advisory clients in a fund's 12b-1 fee paying share class when a lower-cost share class was available for the same fund."[11] In announcing its SCSD Initiative, the Division of Enforcement recommended that investment advisors who had not disclosed the relevant information related to 12b-1 fees "should consider self-reporting to the Division," because in doing so they would be able to "take advantage of the SCSD Initiative, pursuant to which the staff might recommend that the Commission accept favorable settlement terms for self-reporting investment advisers."[12]

13. It appears clear that there are two public policy concerns at the heart of the Commission's efforts related to mutual fund class selection and disclosures. These concerns relate to the obligations to disclose conflicts of interest, and the obligation to seek best execution of customer orders that stem from the fiduciary duties of care and loyalty that investment advisers

[9] United States Securities & Exchange Commission, Share Class Selection Disclosure Initiative, https://www.sec.gov/enforce/announcement/scsd-initiative.
[10] *Id*.
[11] *Id*.
[12] *Id*

owe to their clients.[13] As such it seems clear that investment advisers, such as those at CapWealth, that have eliminated conflicts of interest by rendering such conflicts of interest immaterial by lowering its standard (one (1) percent) advisory fee to offset entirely any 12b-1 fees paid by customers the conflicts of interest have been eliminated and best execution has been achieved.

14. From a governance perspective, the most fundamental insight is that when dealing with conflicts of interest, fiduciaries' first goal should always be to work to avoid such conflicts in the first place whenever possible. It is only if conflicts of interest cannot be avoided that they have to be ameliorated or mitigated through disclosure or other means.[14]

15. In the case of CapWealth, the conflicts of interest posed by the sale of mutual funds with multiple classes were avoided altogether because CapWealth's investment advisers, unlike all of the other investment advisers whose disclosures have been targeted in this enforcement initiative, had no financial incentive to select a higher cost share class that paid a 12b-1 fee, since those very fees were returned to the customer in the form of a reduction in the standard (one percent) advisory fee charged to the customers paying the 12b-1 fees.

[13] Jaqueline M. Hummel, "Why the SEC is Obsessed with Mutual Fund Share Class Selection and Disclosure (and why you should be too)," April 30, 2019, https://www.hardincompliance.com/wp-content/uploads/2018/05/share-class-selection-process-4-30-2018.pdf (accessed June 2, 2020).

[14] Thomas L. Carson, Conflicts of Interest, 13 J. BUS. ETHICS 387, 387 (in ordinary cases it is wrong, all things considered, to allow- an avoidable conflict of interest to occur). See also id, at 392 ("no moral disapprobation ought to attach to agents in unavoidable conflicts of interest."); Jonathan R. Macey and Geoffrey Miller, An Economic Analysis of Conflict of Interest Regulation, 82 IOWA L. REV. 966 (1997); John Boatright, "Conflict of Interest: An Agency Analysis," *in Ethics and Agency Theory,* Norman Bowie and R. Edward Freeman, eds. (Oxford, 1992), pp. 187-203.

IV. Support of Opinions

A. Support for my Opinion One that any alleged failure to disclose was not material. The record indicates, and for purposes of this Report I have assumed, that CapWealth's investment advisors generally selected the share class for its clients that offered the best overall terms of execution available. CapWealth's management practices as they related to fees deprived investment advisors of any incentive to guide clients towards high fee share classes because CapWealth discounted its standard advisory fee (or provided other discounts) to off-set any 12b1 fee imposed by a fund, such as in cases where only a share class that paid a 12b-1 fee was available to a particular investor or where paying a 12b-1 fee and offsetting that fee by a reduction in the investment advisory fee was the most efficient cost structure for the client. This fact differentiates CapWealth from other advisors who may have faced these sorts of conflicts because such other advisers had a financial incentive to select a higher cost share class that paid a 12b-1 fee. This substantive difference makes disclosure immaterial in this context.

16. Any 12b-1 fees paid by CapWealth customers were offset by reductions in the standard advisory fees charged by CapWealth.[15] As such, the net effect on a customer of incurring 12b-1 fees, when accompanied by an offsetting deduction in the standard advisory fee, was zero.

17. Thus, due to this offsetting of fees, the particular 12b-1 fees paid by CapWealth clients were immaterial because an ordinarily prudent, rational investor would not consider such fees to be important or even relevant to his or her investment decision.

18. In the case of CapWealth, the conflicts of interest that ordinarily exist when 12b-1 fees are collected by advisers were avoided altogether because CapWealth's investment advisers, unlike other investment advisers whose disclosures have been targeted in this enforcement initiative, had no financial incentive to select a higher cost share class that paid a

[15] Phoebe Venable, Deposition Before the U.S. Securities & Exchange Commission, April 30, 2020, at 118, 132, (when a fund with 12b-1 fees was selected, "we had made concessions on the fee for the client to take into consideration that we were receiving the 12b-1 fee."). *See also Id*. at page 141 (same).

12b-1 fee, since those very fees were returned to the customer in the form of a reduction in the advisory fees charged to the customers paying the 12b-1 fees.

19. Ms. Phoebe Venable confirmed that when clients were placed in a share class that paid a 12b-1 fee, CapWealth's 1% advisory fee was correspondingly reduced. As established in her deposition, her receipt of 12b-1 fees "was fully disclosed to the clients. The clients knew that it was in our --that it was part of our business model, that it helped us provide small investors and small accounts with a very cost effective way to access our services and we disclosed it."

20. Thus, CapWealth, in order to offset the 12b-1 fees, would provide clients paying such fees with an economic benefit in the form of a corresponding reduction in other fees that they were paying. Such fees would, as Ms. Venable testified "get deducted out of the account as opposed to paid to us from the mutual fund."[16]

B. Support for Opinion Two that the SEC has long taken a practical, holistic approach to disclosure. Here the appropriate disclosures were made in a variety of ways (prospectus, confirmation and in in-person conversations with clients). Any decision to insist that disclosure is only proper and appropriate if it is contained in Form ADV Part 2A is inconsistent with long-standing SEC disclosure policies that provide significant benefits to investors.

21. Mutual funds typically disclose their corporate governance structures and business models and pricing strategies in various filings, including pre-purchase sales materials (brochures), prospectuses, registration statements, annual reports, proxy statements and post-sale confirmations.

22. The two fundamental elements of the SEC disclosure framework are: (1) all material information must be disclosed; (2) when a particular disclosure is made, sufficient

[16] *Id*. at 117-118; 140-141

additional disclosures must be made, if necessary, in order to make such particular disclosures not misleading.

23. Here the record indicates that the 12b-1 fees were disclosed. For example, as Timothy Pagliara, a registered representative and the principal owner of CapWealth, testified at his deposition before the Securities and Exchange Commission, he would explain to clients any receipt of 12b-1 fees verbally and how such fees flowed to him in his role as a registered representative or as an owner of CapWealth.[17]

24. Similarly, Phoebe Venable testified that she discussed with her clients who were investing in a mutual fund that had 12b-1 fees, the nature of those fees verbally. These explanations included a discussion that the 12b-1 fees factored into negotiating a discount on advisory fees. Ms. Venable also explained to her clients that many of the funds in which they were invested had lower cost share classes that did not have 12b-1 fees for which they were eligible.[18] When a specific mutual fund share class was selected Ms. Venable also informed her clients of whether they were eligible for lower cost share classes of the same fund.[19]

25. These disclosures, of course, are the very same ones that the SEC claims should have been made, but in the Form ADV, rather than in actual conversation.

26. Importantly, there are qualitative differences in disclosures, both in terms of the format of such disclosures and in terms of the substance of such disclosures. Specifically, disclosures written with significant jargon or tucked away in a footnote likely will not have the

[17] Timothy Pagliara, Deposition Before the U.S. Securities & Exchange Commission, May 1, 2020, at 107.
[18] Venable Deposition, *supra*, at 139-141.
[19] *Id*.

same force and effect as a disclosures that are written in plain English and featured prominently in disclosure forms, or are carefully explained in-person to a client.

27. Here, in my opinion, the disclosures made here were of the highest quality because they were delivered orally, in an interactive format.

28. From a public policy point of view, it would be misguided to pursue enforcement policies that discourage or diminish the value and importance of in-person disclosures such as those that occurred here.

29. It is well-settled that disclosures can be accomplished in a variety of ways. It does not make sense from a public policy point of view to discourage or diminish one method of disclosure such as oral disclosures, particularly where the alternative disclosure approach likely provides retail clients with more and better information as well as with the opportunity for asking questions and for other interaction.

30. It is well established that investors typically do not read the disclosure documents such as Annual Reports, proxy statements, mutual fund prospectuses, or mutual fund shareholder reports, with which they are supplied by brokers, investment advisers and others.[20] Moreover, it also is widely understood that the primary and dominant source of information for individual investors are communications from their investment adviser or broker.[21] Following investment advisers and brokers as sources of information were the internet, friends and family, magazines, newspapers, with prospectuses ranking barely above television, and only five percent of respondents reporting prospectuses as their main source of information about investments.[22]

[20] Abt SRBI, Mandatory Disclosure Documents Telephone Survey, https://www.sec.gov/pdf/disclosuredocs.pdf
[21] *Id*. at page 4, Figure 3.
[22] *Id*.

31. Specifically with regard to mutual fund prospectuses, an empirical research study using survey methodology specifically directed at mutual fund prospectuses, reported that nearly most investors who received mutual fund prospectuses either "rarely (28%)," "very rarely" (14%), or "never" (12%) read them.[23]

32. In other words, the oral communication of 12b-1 fees by investment advisers that was done by CapWealth was a *superior* mode of disclosure to the alternative, written disclosure that the SEC advocates in its recent SCSD enforcement initiative. By orally communicating the fee information, the advisers made sure that the relevant information actually was conveyed and was not lost inside of some unread document. Moreover, advisers making oral disclosures of 12b-1 fees had the opportunity to make sure that clients fully understood the fees that were being disclosed because such oral disclosure was, by its very nature, interactive, allowing the opportunity for questions and answers, and increasing the odds that such disclosures would be fully internalized by clients.

33. Other cases brought by the SEC presented a different set of facts than the fact pattern presented here. Specifically, in other cases, the SEC brought enforcement actions against respondents who "failed to disclose in their Forms ADV ***or otherwise*** its conflicts of interest related to (a) their receipt of 12b-1 fees, and/or (b) their selection of mutual fund share classes that pay such fees."[24] Here, in stark contrast, the issue is not the complete lack of disclosure, or

[23] *Id*. at p. 56

[24] In the Matter of Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Investment Advisers Act of 1940, Release No. 5199 / March 11, 2019, Administrative Proceeding File No. 3-19102, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) And 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, at 2 (*emphasis supplied*). *See also*, In the Matter of Merrill, Lynch, Pierce, Fenner & Smith, Incorporated, Investment Advisers Act of 1940 Release No. 5479 / April 17, 2020, Administrative Proceeding File No. 3-19753, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) And 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order,

even inadequate disclosure, but rather the fact that the disclosures were made orally, and in writings other than in Form ADV, which, apparently, now is the SEC's preferred vehicle for making this particular disclosure. Clearly, a firm such as CapWealth that has been disclosing its 12b-1 fees, albeit in a non-preferred format, should not be subject to the same sanctions as Merrill Lynch or Wells Fargo that were making either inadequate disclosures or no disclosures whatsoever.

C. Support for Opinion Three that the duty of best execution requires that customers receive the most favorable terms commercially available for their trades. Here the record indicates that CapWealth customers who paid 12b-1 fees received best execution of their trades.

34. The duty of best execution that applies to brokers and investment advisers requires that customers receive the most favorable terms commercially available for their trades.[25] Here the testimony was clear and unequivocal that if a mutual fund had more than one share class and some classes featured 12b-1 fees, but and other classes were not, the investment advisers used the class with the lower fees as long as such a class was available.[26]

35. Moreover, as discussed above, when 12b-1 fees were charged, the investment adviser's standard compensation of one percent or less was reduced to offset such fees.

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at 3 ("At times during the Relevant Period, Respondent did not disclose adequately to its clients either in its Forms ADV or otherwise its conflicts of interest related to (a) its receipt of 12b-1 fees, and/or (b) its selection of mutual fund share classes that pay such fees.").

[25] Jonathan Macey and Maureen O'Hara, The Law & Economics of Best Execution, J. FINANCIAL INTERMEDIATION 6, 188-223, (1997). The legal duty of best execution is widely recognized under securities laws and exchange rules. For example, in establishing NASDAQ, Congress declared its purpose to be assuring ''the practicability of brokers executing investors' orders in the best markets' Courts have noted that "(t)he relationship between a broker/dealer and its customer gives rise to 'certain fiduciary obligations," and that one of these "obligations is a duty to execute the customer's order at the best available price." In re Merrill Lynch, 911 F. Supp. 754, 760 (1995) (cited in In re E.F. Hutton & Co., Securities Exchange Act Release No. 25887, (1988 Transfer Binder) Fed. Sec. L. Rep. (CCH) ¶ 84303, 89326 at 89326 (July 6, 1988); Restatement (Second) of Agency ¶ 1 (1957)). Merrill Lynch at *760 (citing Payment for Order Flow, Exchange Act Release No. 34902 (1994 Transfer Binder) Fed. Sec. L. Rep. (CCH) ¶ 85444, 85849 at 85854 n. 28. Order Execution Obligations, Exchange Act Release No. 34-37619A, 60 Fed. Reg. 48290, 48322.

[26] Deposition of Timothy Murphy before the Securities & Exchange Commission, May 19, 2020, at 83-84.

36. The practices followed by CapWealth in purchasing mutual funds on behalf of clients are precisely what an investment adviser's fiduciary duties require and are consistent with best industry practices.

37. I note that under the forward pricing rule (22c-1),[27] trades in U.S.-based, open-end mutual funds are required to be priced at the next net asset value per share (NAV) calculated after an order is placed. The vast majority of mutual funds calculate their NAVs once per day, usually sometime after 4 p.m. Eastern time. This means that all orders that are placed before 4 p.m. must be priced at the current-day NAV as calculated after the market closes.[28] As such, taking account of rule 22c-1, the duty of best execution for mutual fund trades requires simply that those buying or redeeming mutual fund shares receive the NAV next calculated after the mutual fund receives their order.[29] Costs not related to trade execution, such as soft dollar arrangements and 12b-1 fees present distinct issues entirely separate and apart from best execution.

38. However, as the analysis here shows, to the extent that the concept of best execution is expanded by the SEC in its enforcement actions to include the imposition of post-execution mutual fund fees, such as 12b-1 fees, all fiduciary duties, including the expanded duty of best execution were met.

[27] The forward pricing rule is Investment Company Act Rule 22c-1, 17 CFR 270.22c-1(a), pursuant to which underwriters, and dealers must sell and redeem fund mutual fund shares at the price determined by the net asset value ("NAV") for the funds's shares that is next computed after receipt of an order to buy or redeem such shares. The rule also requires that funds calculate their NAV at least once a day, which is typically after the major markets close at 4:00pm eastern time.
[28] Eric Zitzewitz, How Widespread Was Late Trading in Mutual Funds? 96 AMER. ECON. REV. 284 (2006).
[29] See also Deposition of Timothy Pagliara, *supra*, at 123-125 (making this point).

D. Support for Opinion Four that the Record shows that CapWealth's corporate governance and culture was directed at instilling a culture of compliance in the firm. This indicates that a lack of scienter or intention to engage in wrongdoing.

39. CapWealth used independent consultants to craft the disclosures in its Form ADV Part 2A, and in other disclosure documents. The purpose of retaining such consultants was to ensure that the firm's disclosures met all applicable regulatory disclosure requirements. In particular, as Ms. Venable attested in her deposition the firm hired two outside consultants to help with disclosure issues: "We've had two (consultants). For a number of years it was BrightHouse and the principal there was Howard Landers. And then subsequent to that is Asgard and the principal there is Jon Hurd."[30]

V. Conclusion

40. CapWealth's investment advisors generally selected the share class for its clients that offered the best overall terms of execution available. CapWealth's management practices, as they related to fees, deprived investment advisors of any incentive to guide clients towards high fee share classes because CapWealth discounted its standard advisory fee (or provided other discounts) to off-set any 12b-1 fee imposed by a fund, such as in cases where only a share class that paid a 12b-1 fee was available to a particular investor or in cases in which paying a 12b-1 fee and then offsetting that fee by a reduction in the investment advisory fee was the most efficient cost structure for the client. This fact completely differentiates CapWealth from other advisors who may have faced conflicts because they had a financial incentive to select a higher cost share class that paid a 12b-1 fee. This important substantive difference makes disclosure immaterial.

[30] Deposition of Phoebe Venable, *supra,* at 122.

41. The SEC has long taken a practical, holistic approach to disclosure. In particular, fulsome disclosure is encouraged, so long as information necessary in order to make fulsome disclosure not misleading also is made. And corrective disclosure is encouraged, as are disclosures in formats appropriate for investors. Here the appropriate disclosures were made in a variety of ways (prospectus, confirmation and in-person). Any decision to insist that disclosure is only proper and appropriate if it is contained in Form ADV Part 2A represents a conflict with long-standing SEC disclosure policies that provide significant benefits to investors. The fees were disclosed in the mutual fund prospectuses and in the confirmations sent to customers purchasing. It would be bad public policy to diminish the other disclosures.

42. Further with respect to overall execution quality and customer experience, CapWealth's method for executing trades in funds with 12b-1 fees was in the best interests of its clients when viewed from a tax planning perspective. Having a client first pay the 12b-1 fees associated with a fund and then having the amount of the advisory fee returned to the client through a reduction in the annual advisory fees by an offsetting amount preserved the deductibility of such fees. This is because the advisory fees are not fully deductible, while the 12b-1 fees are treated as a necessary and ordinary business expense and are deductible from the net gains of the fund.[31]

43. The duty of best execution that applies to brokers and investment advisers provide their customers the most favorable terms commercially available for their trades. Here the record indicates that CapWealth customers who paid 12b-1 fees received best execution of their trades.

[31] Section 11045 of the Tax Cuts and Jobs Act of 2017 eliminated the deductibility of all miscellaneous expenses, including investment advisory fees, subject to the 2 percent limitation for the years 2018 through 2026. But the 12b-1 distribution and service fees a mutual fund pays to investment advisors continue to be deductible under 26 U.S.C. §162.

I attest to holding the opinions discussed in the above Report to a high degree of certainty.

Respectfully submitted,

Jonathan Macey
June 13, 2020

Appendix A

Curriculum Vitae

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Education: J.D. Yale Law School; Article and Book Review Editor, Yale Law Journal, 1982; A.B., cum laude (economics), Harvard College, 1977.

Current Positions:

- Sam Harris Professor of Corporate Law, Finance, and Securities Regulation, Yale University
- Professor, Yale School of Management
- Chair, Yale University Advisory Committee on Investor Responsibility (ACIR)
- Chair, Yale Faculty Committee on Athletics
- Executive Committee, Yale Law School Center for the Study of Corporate Law
- Provost's Standing Advisory and Appointment Committee (SAAC) for the Yale School of Management
- Economics Advisory Board, Financial Industry Regulatory Authority, (FINRA)
- Member, European Corporate Governance Institute (ECGI)

Subjects: Business Organizations (Corporations and Other Business Associations); Corporate Finance; Corporate Governance; Banking and Financial Institutions Regulation; the Economics of Regulation

Other: Ph.D. (Law) *honoris causa* Stockholm School of Economics, 1996

D.P. Jacobs prize for the most significant paper in volume 6 of the Journal of Financial Intermediation for "The Law & Economics of Best Execution" (co-authored with Maureen O'Hara) (1997)

Paul M. Bator Award for Excellence in Teaching, Scholarship and Public Service awarded by the University of Chicago Law School Chapter of the Federalist Society, 1995

Bipartisan Policy Center (BPC) Financial Regulatory Reform Initiative's Working Group on Capital Markets

Fellow, Columbia Law School and Columbia Business School, Program in the Law & Economics of Capital Markets

Founding Member, CCH/Aspen Wolters Kluwer Law & Business, Banking and Securities Editorial Board

Books:

"Cases and Materials on Corporations Including Partnerships and Limited Liability Companies" (Thomson*West, Thirteenth Edition 2017) (with Robert Hamilton and Douglas Moll)

"The Law of Banking and Financial Institutions" (Aspen Law &Business, sixth edition, 2017) (with Richard Cornell and Geoffrey P. Miller)

"Macey on Corporation Laws" (2 volume treatise), originally published in 1998, updated annually, Wolters Kluwer Law & Business, 2017 (updated annually)

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Remarks at Colloquium on the ALI Corporate Governance Project, 71 Cornell Law Review. (assorted pages) (1986)

"A Conduct Oriented Approach to the Glass-Steagall Act," 91 Yale Law Journal 102 (1981) (published as a student)

Recent Testimony

"Measuring the Systemic Importance of U.S. Bank Holding Companies," Senate Banking Committee Hearing, July 23, 2015

Current Activities:

Member, American Law Institute;

Members Consultative Group for American Law Institute's Restatement of the Law/Corporate Goverance Project;

Editorial Board, Journal of Accounting, Finance and Law;

Academic Advisory Board Committee, the Banking Law Anthology;

Academic Advisory Board, The Social Philosophy and Policy Center;

Board of Editors, Journal of Banking and Finance;

Board of Editors, Journal of Banking Law;

Board of Editors, Journal of Financial Crime;

Board of Editors, Corporate Practice Commentator;

Guest Contributor, Harvard Corporate Governance Blog

Employment History:

Sam Harris Professor of Corporate Law, Securities Law and Corporate Finance, Yale University, 2004 – present;

Visiting Professor, Bocconi University, Milan, Italy, fall 2012;

Visiting Professor of Law, Yale University, 2003-2004;

J. DuPratt White Professor of Law, Cornell Law School, 1991-2004;

Visiting Professor of Law, Harvard Law School, 1998-1999;

Visiting Professor, Faculty of Law, Stockholm School of Economics, fall, 1993;

Research Fellow, International Centre for Economic Research, Turin Italy, winter, 1993, spring, 1994;

Professor of Law (with tenure), University of Chicago, 1990-1991;

Professor of Law, (with tenure), Cornell University, 1987-1990;

Visiting Professor of Law, The University of Chicago, fall quarter, 1989-1990;

Visiting Professor, University of Tokyo Faculty of Law, summer, 1989;

Visiting Associate Professor of Law, University of Virginia, 1986-1987;

Assistant to Associate Professor of Law, Emory University, 1983-1986;

Law Clerk to the Honorable Henry J. Friendly, United States Court of Appeals, Second Circuit, 1982-1983 term of court;

Consultant, Municipal Finance Department, Lloyd Bush & Associates, New York, NY (consultant representing municipalities and investment banks before credit rating agencies (1978-1979));

Municipal Bond Trader, Bankers Trust Company, New York, NY (1977-1978);

Member, Board of Directors, Telxon Corporation, 1998-1999 (appointed as dissident director in settlement of proxy contest dispute); Member, Board of Directors, WCI Communities, Inc., 2007-2009; Member, Board of Directors, Shred-It Connecticut, 2007-2010; Alternative Director nominee for Illumina, Inc., 2012, Hess Corporation; 2015; Director nominee Rexene Corporation, 1999, Circon Corporation, 1998, Arvin Meritor, Inc. 2004, Wynn Resorts, Ltd. 2012, Family Dollar Stores, 2014 (among others).

Current consulting rate: $1,250.00 per hour.

Appendix B

Jonathan Macey -- Prior Expert Testimony as of May 13, 2020

Year	Case Name	Court	Testimony Given
2015	New York v. Maurice Greenberg	Supreme Court of the State of New York, County of New York	Deposition Testimony
2015	State of Connecticut v. The McGraw Hill Companies, and Standard & Poor's	Superior Court, Judicial District of Hartford, Hartford, CT	Deposition Testimony
2015	George L. Miller, Chapter 7 Trustee, v. Kirkland & Ellis	United States Bankruptcy Court, District of Delaware	Deposition Testimony
2015	In the Matter of Office of the Comptroller of the Currency v. James E. Plack	U.S. Department of the Treasury, Office of the Comptroller of the Currency	Deposition Testimony
2015	Paolo Moreno v. SFX Entertainment, Inc.	United States District Court for the Central District of California, Western Division	Deposition Testimony
2015	Future Select v. Tremont Group Holdings	Superior Court for the State of Washington for King County	Deposition Testimony
2015	Panattoni Development Company, Inc. v. Scout Funds 1-A, LP and 1-C, LP	Supreme Court of the State of New York, County of New York	Deposition Testimony
2016	Crystal Good, et al. v. American Water Works Company, Inc., et. al	United States District Court for the Southern District of West Virginia	Expert Report
2016	CaremarkPCS Health, L.L.C. v. Walgreen Co.	American Arbitration Association, Phoenix, AZ	AAA Arbitration Hearing Testimony
2017	SLSJ, LLC v. Kleban	United States District Court for the District of Connecticut	Expert Report
2017	Robinson Mechanical Contractors, Inc. v. PTC Group Holdings Corp.	United States District Court for the Eastern District of Missouri, Southeastern Division	Deposition Testimony
2017	Vikas Goel v. American Digital University, Inc.	Supreme Court of the State of New York, County of Westchester	Expert Report
2018	In the Matter Of NewSat Limited (In Liquidation	Federal Court of Australia District Registry: Victoria Division: General	Joint Expert Witness Statement

2018	United States of America v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner, Inc.	United States District Court for the District of Columbia	Deposition Testimony
2018	Blueblade Capital Opportunities LLC, v. SciQuest, Inc.	Court of Chancery of the State of Delaware	Deposition Testimony
2019	Deere & Company v. Hitachi Construction and Machinery Co., Ltd. v. Hitachi Construction and Machinery Co., Ltd	International Chamber of Commerce International Court of Arbitration, Paris, FR	Expert Report
2019	Maurice Greenberg v. Eliot L. Spitzer	Supreme Court of the State of New York, County of Putnam	Deposition Testimony
2019	In Re: National Prescription Opiate Litigation	U.S. District Court for the Northern District of Ohio	Deposition Testimony
2019/ 2020	Party City Corporation v. Cayan LLC	American Arbitration Association	Deposition Testimony/ AAA Arbitration Hearing Testimony
2020	In re; ASHINC Corporation, et. al, debtors, Catherine Youngman Litigation Trustee v. Black Diamond Opportunity Fund II, LP	United States Bankruptcy Court for the District of Delaware	Deposition Testimony
2020	A.O.A. *et al*. v. Doe Run Resources Corporation, *et. al*.	United States District Court for the Eastern District of Missouri, Eastern Division	Deposition Testimony
2020	Wai Chun Shek v. Luckin Coffee Inc.,	United States District Court for the Southern District of New York	Expert Report

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